REBUTTAL TESTIMONY

OF

DIANNA HATHHORN

ACCOUNTING DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

AMERITECH ILLINOIS

DOCKET NOS. 98-0252/98-0335 (CONSOL.)

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Witness and Exhibit/Schedule Identification

Q. Please state your name and business address.

A. My name is Dianna Hathhorn. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Have you previously filed testimony in this proceeding?

A. Yes, direct testimony was filed in November 2000.

Q. What is the purpose of this testimony?

A. I am presenting testimony regarding the following adjustments from my direct testimony: Pension Settlement Gains, and Plant Under Construction. I am also addressing certain adjustments proposed by the intervenors.

Q. Are you sponsoring any schedules as part of Staff Exhibit 20.0?

A. Yes, I have prepared (or supervised the preparation of) the following schedules for the Company, which show data as of, or for the test year ending December 31, 1999:

Schedule 20.01	Adjustment to Pension Settlement Gains
Schedule 20.02	Adjustment to Plant Under Construction

Contested Adjustments

Pension Settlement Gains

Q. Have you revised your Staff Exhibit 6.0, Schedule 6.03?

A. Yes, I have, and it is presented in my Staff Exhibit 20.0, Schedule 20.01. My schedule is revised to address the Company's updated Pension Settlement Gains, reflecting an allocation of Ameritech Services, Inc.'s 1999 pension settlement gains to Ameritech Illinois. (Ameritech Illinois Ex. 7.1, pp. 2-3).

Q. How is your Schedule 20.01 different than your Schedule 6.03 presented in your direct testimony?

A. Schedule 20.01 includes my original pension settlement gain adjustment, presented on page 2 of 4, but it also includes an adjustment to normalize the pension settlement gain allocated to the Company from Ameritech Services, Inc. The methodology used for this new part of the adjustment is the same as the original, that is, I analyzed historical pension settlement gains of Ameritech Services, Inc., determined a normalized level, and adjusted the 1999 abnormal gain accordingly. These calculations are shown on pages 3 and 4 of Schedule 20.01. Page 1 of Schedule 20.01 summarizes the two pieces of the adjustment, so that Staff's revenue requirement reflects one pension settlement gain adjustment amount.

Q. The Company states that it is not appropriate to consider the pension settlement gains as a current period (1999) gain in this process. Please respond.

A. I agree with this statement, however there is more than one option to achieve this result. The Company has chosen to completely remove the transaction from the 1999 revenue requirement, as if it never occurred. Alternatively, I have analyzed historical Company data (Schedule 20.01, page 4) and determined that settlement gains do occur with annual frequency, just not in the magnitude of the 1999 gains. Therefore it is appropriate to adjust the 1999 gains down to a normal level; the data shows that the normal level is not zero.

Q. The Company's position is that, since its rates are based upon a price cap formula and not a revenue requirement, ratepayers have not been paying for pension expense. (AI Ex. 7.1, pp. 34-35) Please respond.

A. The Company has not identified how pension expense is excluded from the price cap formula in any way. (Company response to DLH-061). While it is true that the revenue requirement in the original Alternative Regulation case, Docket Nos. 92-0448/93-0239 (Consol.) (hereinafter referred to as "Alt. Reg.") did not contain a provision for pension expense, the reasoning was due to the fact the Company had negative pension expense at the time. (AI Ex. 7.1, p. 34). Neither the revenue requirement in that proceeding, nor the inputs for the price cap formula used today, contain any factors or adjustments to exclude pension expense from the cost of service to ratepayers. Therefore, pension expense, and any related settlement gains, should be treated as an above the line item and not be disallowed because the historical level of pension expense was negative at the time of the last revenue requirement determination.

Plant Under Construction

Q. Have you reviewed the Telephone Plant Under Construction and Interest During Construction ("IDC") adjustment made by GCI witness Smith (GCI Exhibit 6.1, Schedule E-13)? Note: IDC is also known as Allowance for Funds Used During Construction ("AFUDC").

A. Yes, I have. The issues overlap with my original adjustment in my Schedule 6.02. In reviewing Mr. Smith's adjustment and conducting research to answer Company discovery questions, I determined my original adjustment needed to be revised. I agree with Mr. Smith that an adjustment is needed to prevent the double recovery of IDC. The Company has also accepted Mr. Smith's adjustment. (AI Ex. 7.1, p.7). In my opinion though, for reasons discussed below, a different method should be used to address the IDC adjustment.

Q. What method do you propose?

A. I propose to exclude the IDC-generating balance of Telephone Plant Under Construction ("TPUC") balance from rate base. Therefore, IDC would only be allowed in rate base as it transfers from TPUC to Plant in Service.

Q. Why do you prefer your method to that of Mr. Smith's?

A. I have two reasons, one theoretical and one legal. First, IDC is a "below-the-line" item. To artificially bring a "below-the-line" item into the revenue requirement appears confusing and contrary to the regulatory model of reflecting only recoverable costs. A clearer conclusion results if the duplicated IDC amount is simply not allowed to earn a return by removing it from rate base.

Q. What are the legal requirements of the Public Utilities Act concerning Construction Work in Progress ("CWIP")?

A. Section 9-214 (d), quoted below, disallows CWIP, also known as Plant Under Construction, from being included in rate base:

> "The Commission shall not include an amount for CWIP in the rate base for any public utility for the period after December 31, 1988."

Therefore, in my opinion, Mr. Smith's adjustment, although the Company has accepted it (AI Ex. 7.1, p. 7), is not in compliance with the Act and therefore must be changed.

Q. Mr. Smith states that Plant Under Construction was allowed in rate base in the Company's revenue requirement in the original Alt. Reg. proceeding. (GCI Exhibit 6.0, p. 45, lines 7-11). Please explain.

A. The Commission's practice is to allow the non-IDC earning portion of Plant Under Construction in rate base. Section 9-214 (e) of the Act also allows for CWIP in rate base for investments scheduled to be placed in service within 12 months of the rate determination. Therefore, it is reasonable that some portion of Plant Under Construction was allowed in the previous Alt. Reg. proceeding, although a better description such as "Non-IDC Plant Under Construction" would have been more clear.

Q. Please describe your Schedule 20.02.

A. My Schedule 20.02 revises my original Schedule 6.02, Adjustment to Plant Under Construction. It reflects the test year TPUC using the 12/31/99 year end balance of the non-IDC generating TPUC balance.

Q. What would be the result if the IDC-accruing TPUC is allowed to remain in rate base?

A. The Company would be allowed a double-recovery of the financing costs of the TPUC since the TPUC is also earning a rate of return.

Q. How does your revised adjustment compare with that of Mr. Smith's that the Company has accepted?

A. The bottom-line operating income affect is essentially the same. My rate base disallowance of $24,275,000 at Staff's rate of return of 10.52% yields a $2.554 million disallowance to operating income, as compared to $2.245 million from Mr. Smith's adjustment.

Q. How does your revised adjustment affect your previously submitted Schedule 6.02?

A. My Schedule 20.02 replaces Schedule 6.02.

Accruals for Asset Disposition Cost

Q. Please comment on GCI's adjustment for Accruals for Asset Disposition Cost. (GCI Exhibit 6.1, Schedule E-5)

A. I have reviewed this adjustment and find no basis for challenging it. The Company is opposed to the adjustment. Since it is not agreed upon nor proposed by Staff, it is not reflected in Staff's revenue requirement.

Non-Contested Adjustments

Materials and Supplies

Q. Please comment on GCI's Materials and Supplies adjustment (GCI Exhibit 6.1, Schedule E-12).

A. I have reviewed this adjustment and find no basis for challenging it. Since the Company and GCI have reached agreement, it is reflected in Staff's revenue requirement, included as a part of the beginning balance of the Company rebuttal position.

<u>Software Capitalization (98-01)</u>

Q. Please comment on GCI's Software Capitalization (98-01) adjustment (GCI Exhibit 6.1, Schedule E-10).

A. I have reviewed this adjustment. The Company and GCI have reached agreement on the need for this adjustment, however there is a difference in the amounts presented for the adjustment. I have reviewed both calculations and agree with the Company's calculation. Since there is no disagreement in the need for the adjustment, it is reflected in Staff's revenue requirement, included as a part of the beginning balance of the Company rebuttal position.

<u>Federal Income Tax Calculation</u>

Q. Please comment on the Company's Federal Income Tax Calculation adjustment (Ameritech Illinois Ex. 7.1, Schedule 3, Column B).

A. I have reviewed this adjustment, which is included in Column B of AI Ex. 7.1, Schedule 1 labeled "Prior Period Taxes & Non Regulated", and find no basis for challenging it. Since the Company and GCI have reached agreement, it is reflected in Staff's revenue requirement as well and is included as a part of the beginning balance of the Company rebuttal position.

Merger Planning and Implementation Costs

Q. Please comment on the Company's response to your Adjustment to Merger Planning and Implementation Costs (Staff Exhibit 6.0, Schedule 6.01).

A. The Company, GCI, and Staff have reached agreement. The adjustment is reflected in Staff's revenue requirement, included as a part of the beginning balance of the Company rebuttal position.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.